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Financial Innovation and Bank Performance: A Literature Study

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ABSTRACT

This paper aims to review previous articles on the impact of financial innovation towards bank performance. Several articles were extracted from various online resources such as emerald insight, science direct and google search engine for the period of 2004 until 2018 in order to see the relationship. Most of the literature studies indicate that the financial innovation has a significant positive relationship with the performance. It seems that bank could gain a high potential of financial performance improvement by adopting new financial technology. Thus, this study will start with reviewing several past articles in order to find out the relationship between Financial innovation adoptions on bank performance.

Keywords: Financial Innovation; Financial Technology; Bank Performance

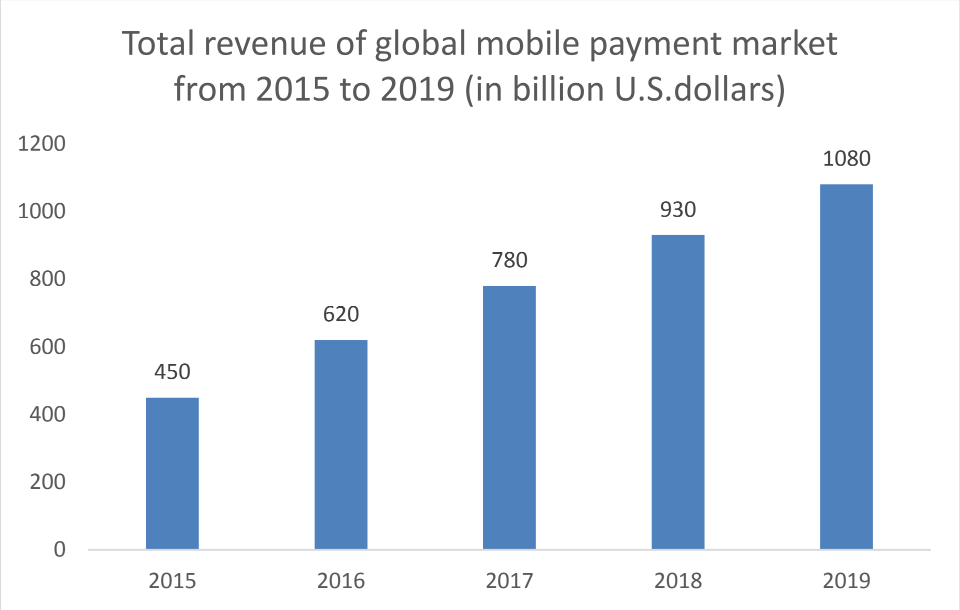
INTRODUCTION

Nowadays, banks and many financial institutions have invest a big amount of capital on the innovation of financial technology. The main aim is to improve the business financial performance and to enlarge the share market scale.

Banks have introduced many financial innovations that are positively contributed to the development of the whole economy. Jarunee (2017) mentioned that the banking landscape has witnessed the development of various FinTech-based innovations like electronic fund transfer at the point-of-sale (EFTPOS), automated teller machine (ATM cash dispenser), internet banking, Society for Worldwide Interbank Financial Telecommunication (or SWIFT) international electronic fund transfer, Electronic Data Interchange (EDI), mobile banking, Bitcoin wallet, Blockchain banking and crowd funding.

Nejad (2016) explained that financial innovations are the online and mobile financial transactions, expansion of electronic payments and exchanges processing, new payment services such as Apple Pay and Android Pay, money management such as Google Pay, digital currency such as Bitcoin, peer-to-peer lending services websites, usage-based insurance, and longevity bonds and swaps.

The Table 1.1 below shows the revenue of global mobile payment market from 2015 to 2019.

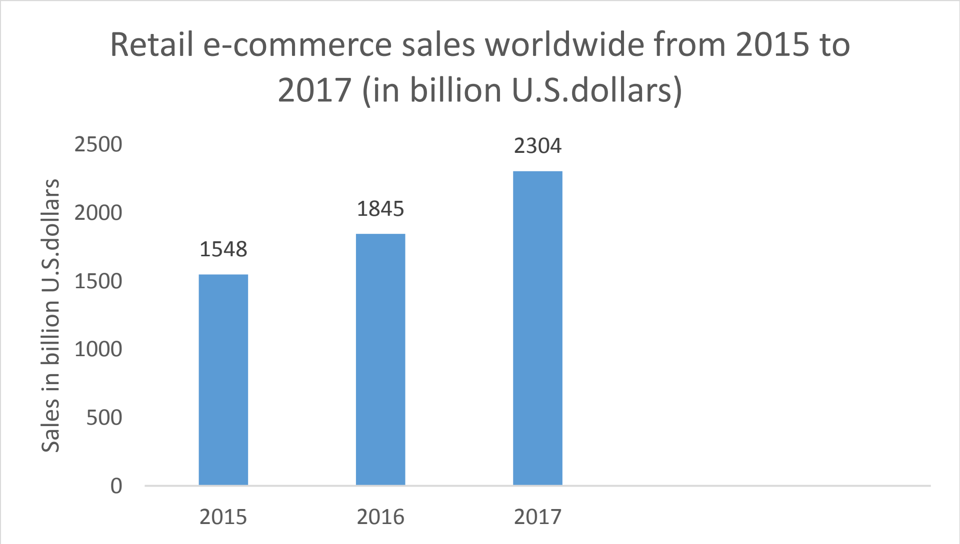


Source: The Statistic Portal (https://www.statista.com)

Table 1.1 indicates that the revenue from global mobile payment market shows the demand for the service is keep increasing from year 2015 up to year 2019. This is because many customers need this kind of services that can help them to have a faster time to solve their financial transaction.

In this era, we can see many banks have make a movement from the use of traditional banking services to the high technology banking services. The financial innovations in financial technology is also contributed by the behavior of retail e-commerce. Many young people and adult more prefer to do online transaction as it is more time consuming. Table 1.2 below shows the sales from retail e-commerce from year 2014 until year 2017.

Table 1.2 Retail e-commerce sales worldwide from 2015 to 2017 (in billion U.S.dollars)



Source: The Statistic Portal (https://www.statista.com)

Statista Digital Market Outlook reported that the global fintech market is huge. The transaction value of the global Fintech market has reached US$2.6 trillion in the year 2016 and it is expected to continue its growth to almost US$7 trillion in year 2021 They also reported that value of bank spending on new technologies are expecting keep increasing from year 2015 to 2017. It was 17 billion dollars in 2015 and 19.9 billion dollars in year 2017 in North America. In Europe, banks spent 10.9 billion dollars in 2015 and increase to 15.3 billion in year 2017. Similar goes to Asia Pacific, the value keep growing from 20.5 billion in year 2015 to 22.1 billion in year 2017. By looking at the figures, we can conclude that there must be a significant reason that boom up the value of FinTech all around the world. Thus, this paper aims to review past articles on financial innovation in order to know its impact to the bank performance.

LITERATURE REVIEW

Tahir et al.(2018) studied on the impact of financial innovation on performance in Pakistan. The study found that there were significant positive relation of transactions on the Web/Internet on Efficiency Ratio. But the results for Automated Teller Machines (ATM), Point of Sale (POS), and Mobile Banking (MOB), were found to be statistically non-significant. Furthermore, the Granger impact appraisal revealed that no innovative products had a critical effect on Efficiency Ratio, but they did have a significant effect on the value of transactions. Federico (2017) studied on the impact of the Fintech on banks' financial performance. The results of the study suggest that the existence of a significant positive relationship between the technological innovation (fintech) and bank profitability. The finding also indicate the existence of a negative relationship between the number of physical branches and bank profitability.

Fadi Hassan et al (2018) focused their study on financial inclusion improve bank performance in Jordan. This research study the impact of six Financial Inclusions (credits for small and medium enterprises (SMEs), deposits for SMEs, number of ATMs, number of ATM services, number of credit cards, and new services) on banks. The results of the study indicate that all variables have a positive coefficient with gross income, and some of these coefficients, such as ATMs, ATMs services, SMEs credits, and SMEs deposits, are highly correlated.

Susan et al (2017), focused their study on the long term effect of digital innovation on bank performance by focusing on SWIFT adoption in financial services. The results of the study suggest that the adoption of SWIFT (a network-based technological infrastructure and set of standards for worldwide interbank telecommunication) (i) Has large effects on profitability in the long-term; (ii) these profitability effects are greater for small than for large banks; and (iii) exhibits significant network effects on performance.

Vivien et al (2016) study on Effect of Financial Innovation on the Growth of Commercial Banks in Eldoret Town, Uasin Ishu County. The findings of the study indicate that all the predictor (Internet banking, m-banking) showed that there was statistical significant effect on the dependent variable growth of commercial bank.

Leonard et al (2017) studied on Information Technology (IT) and firm performance finds that there is a relationship between IT integration and firm performance. This is supported by Bernardo (2004) that the result of his study suggest changes in performance benchmarks for service delivery resulting from new technology are associated with greater competitive rivalry among financial service organizations. Results also suggest that technological change can provide new and innovative ways to exchange information but even if that is the case, incentives for internal and external co-operation can remain unchanged. Elena (2017) study on IT and bank performance in European banks. Her study founds that there is little relationship between total IT investment and improved bank profitability or efficiency indicating the existence of a profitability paradox. However, Elena (2017) states that the impact of difierent types of IT investment (hardware, software and services) on banks' performance is heterogeneous.

Raymond et al (2016) studied on The influence of technological innovation on bank performance in Meru town, Kenya. The research findings states that the financial performance of commercial banks` branches in Meru towns is positively influenced by innovation. Innovations adoption by commercial banks presents a high potential of financial performance improvement therefore yielding increased returns for the shareholders. The financial innovation also can process a higher volume of transactions compared to the use of the conventional manual processes.

DISCUSSION AND CONCLUSION

As far as we concern, the impact of financial innovation in banking and financial sectors performance are significants and relevant. It plays an important role and become one of the key drivers of performance. Nowadays, it became another hot issue to be debated in banking and finance industry. Besides the positive impact we do believe that the drastic changes in financial technology without any controlled by certain bodies may give harm. So, it must be strongly monitored and well regulated by the regulator. This innovation not only practical to be adopt in banking institutions and financial institutions but also relevant to other supporting financial institutions to improve their service and finally could lead to a better performance.

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